



The Dominant Undertaking's Prices and Discounts

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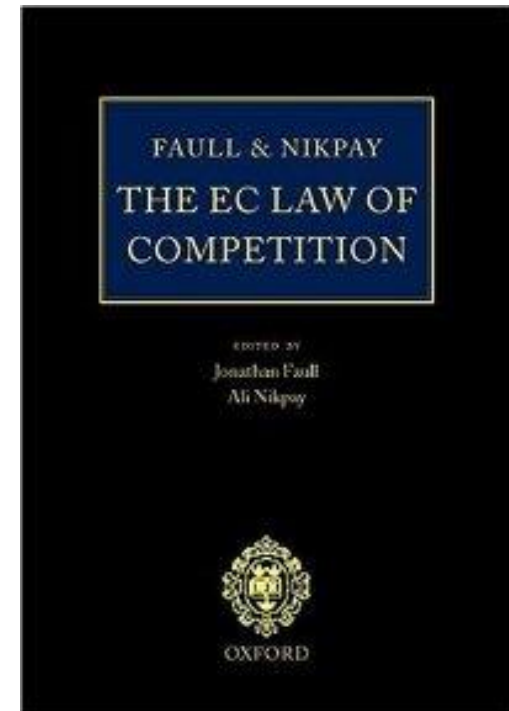
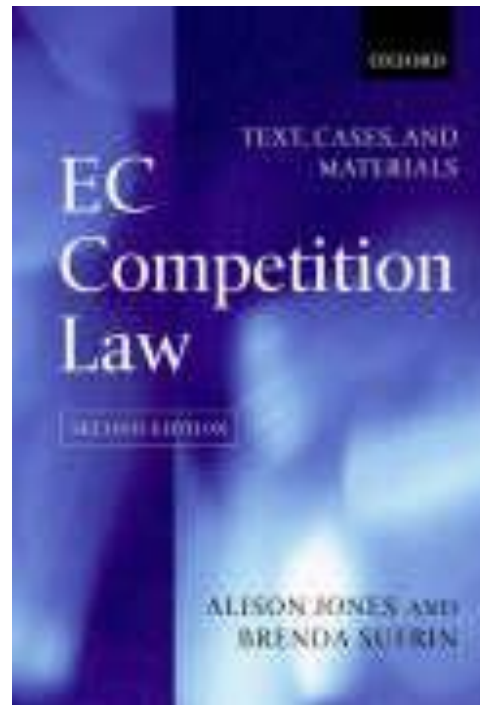
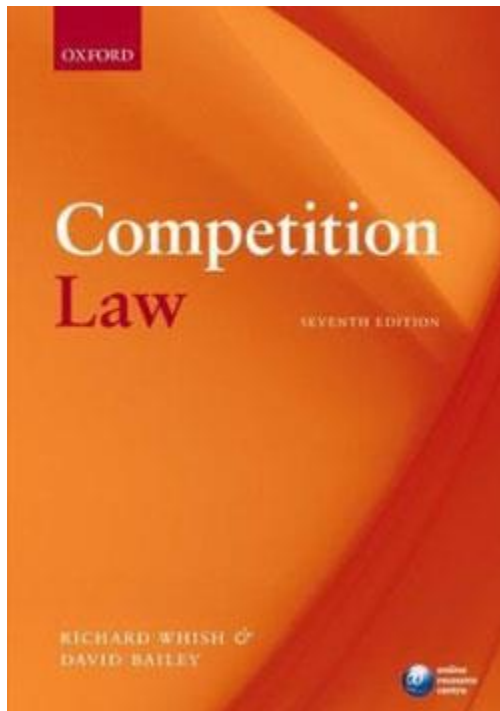


The Dominant Undertaking's Prices and Discounts

LUND - 24 November 2014



Different texts on Competition Law



Am I correct in understanding you can choose different books for this course?

However, none outlines discounts in detail

Instead, they focus on various aspects of Article 102



Some interesting insights on discounts

In cases such as *UBS & Michelin*, the Court of Justice held:

“The dominant position thus referred to by Article [102] relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”

This essentially defines dominance as the ability to ignore customers.



Why discounts?

Nevertheless, even dominant companies offer their customers discounts and discounts programs



In reality, discounts are everywhere



DSB Orange Bornholm

København - Rønne

129,-



Få et Coop-kort - og få mere med hjem!



Why discounts?

Two explanations, of which (only) one is anti-competitive



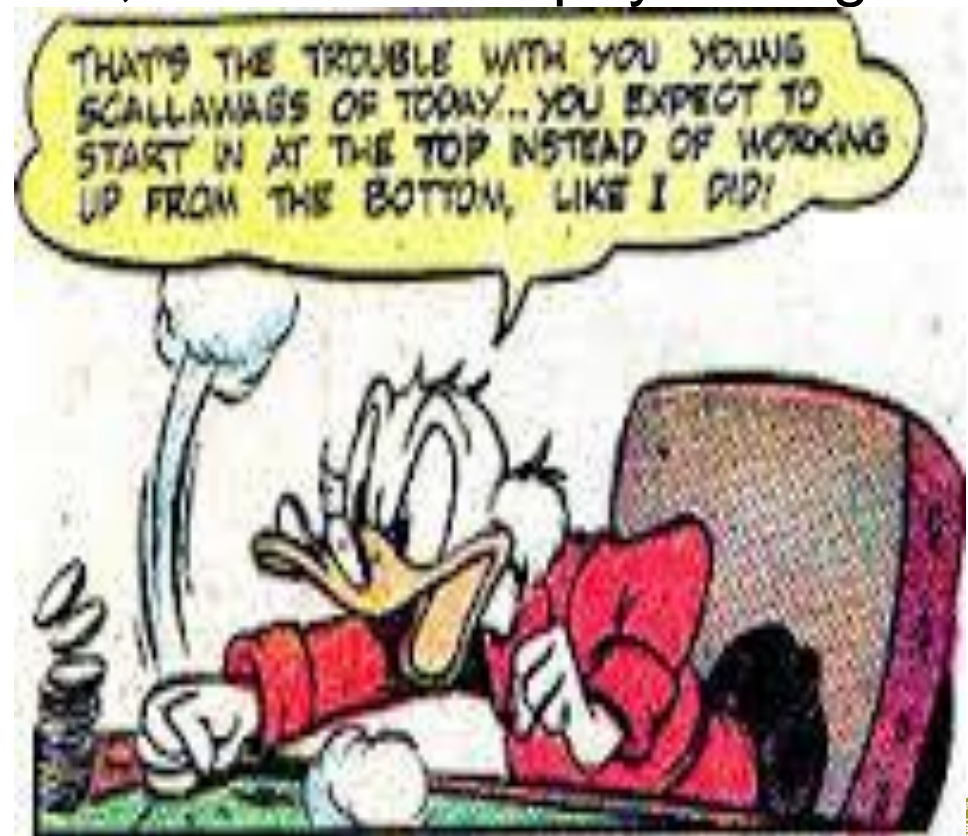
The anti-competitive explanation

- a) The anti-competitive explanation revolves around a foreclosure strategy (customer foreclosure) where customers, through a loyalty program (discounts), are reserved for the dominant undertaking and denied for the competitors



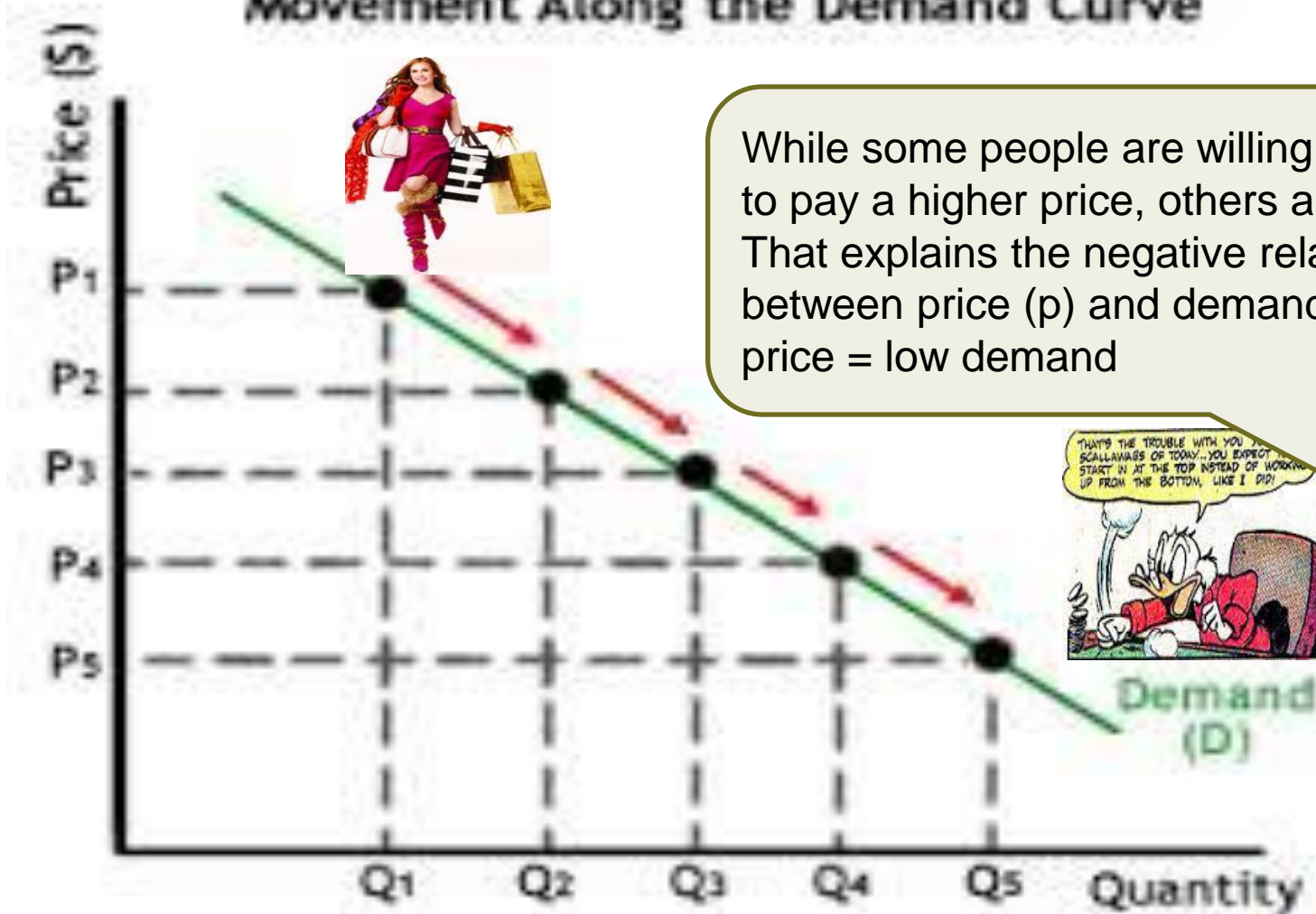
However, there is an alternative explanation

- b) Some people are willing (and able) to spend more (money) than others, and hence pay a higher price

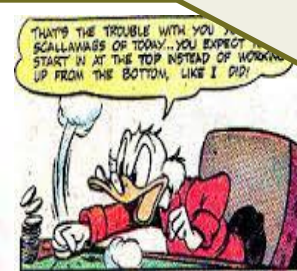


The alternative explanation

Movement Along the Demand Curve

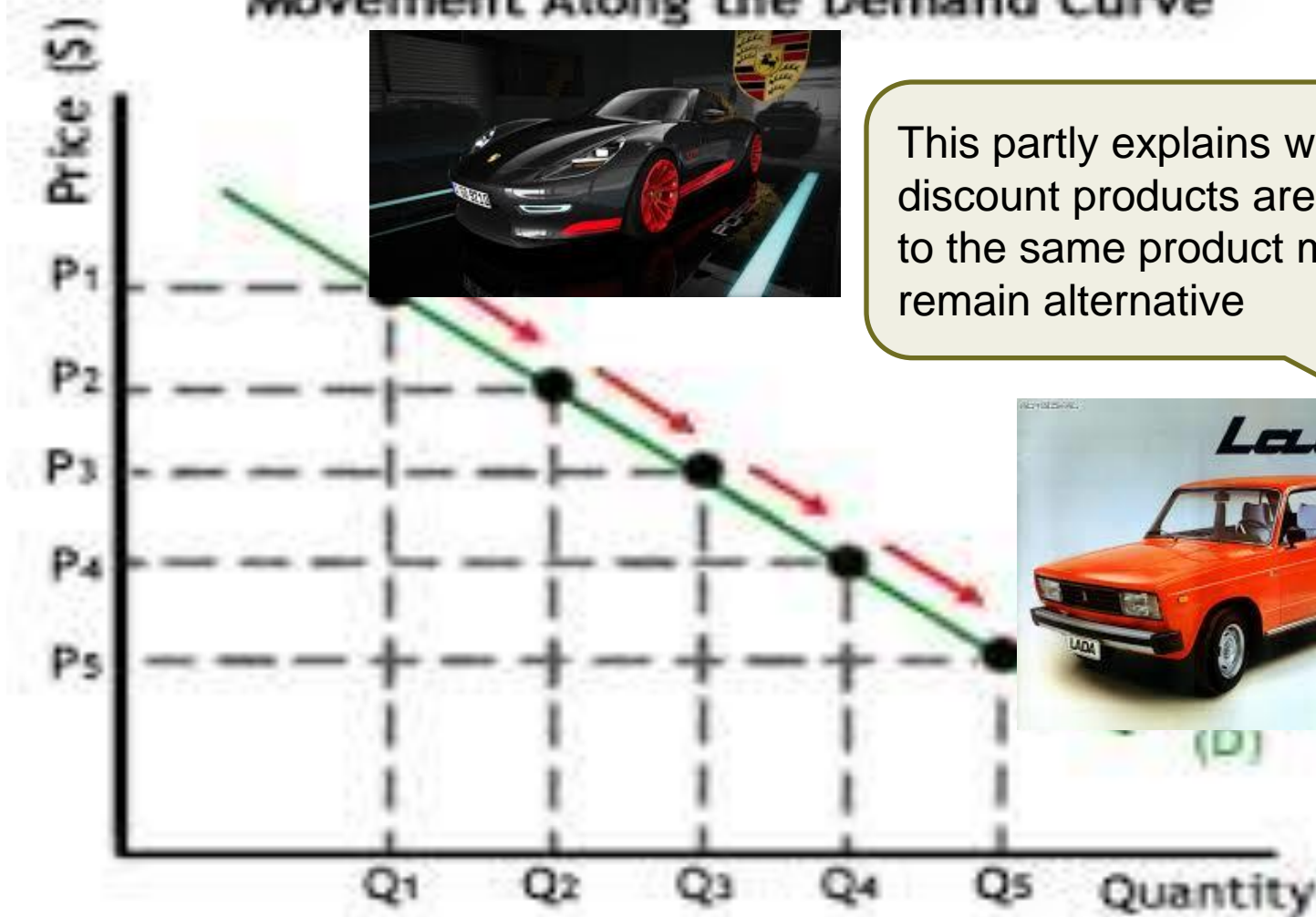


While some people are willing (and able) to pay a higher price, others are not. That explains the negative relation between price (p) and demand (q). High price = low demand



The alternative explanation

Movement Along the Demand Curve



This partly explains why luxury & discount products are attributed to the same product market and remain alternative



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The alternative explanation



Some companies address the challenge by offering a broad program with different sub-brands



The alternative explanation



DSB Orange Bornholm

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129,-

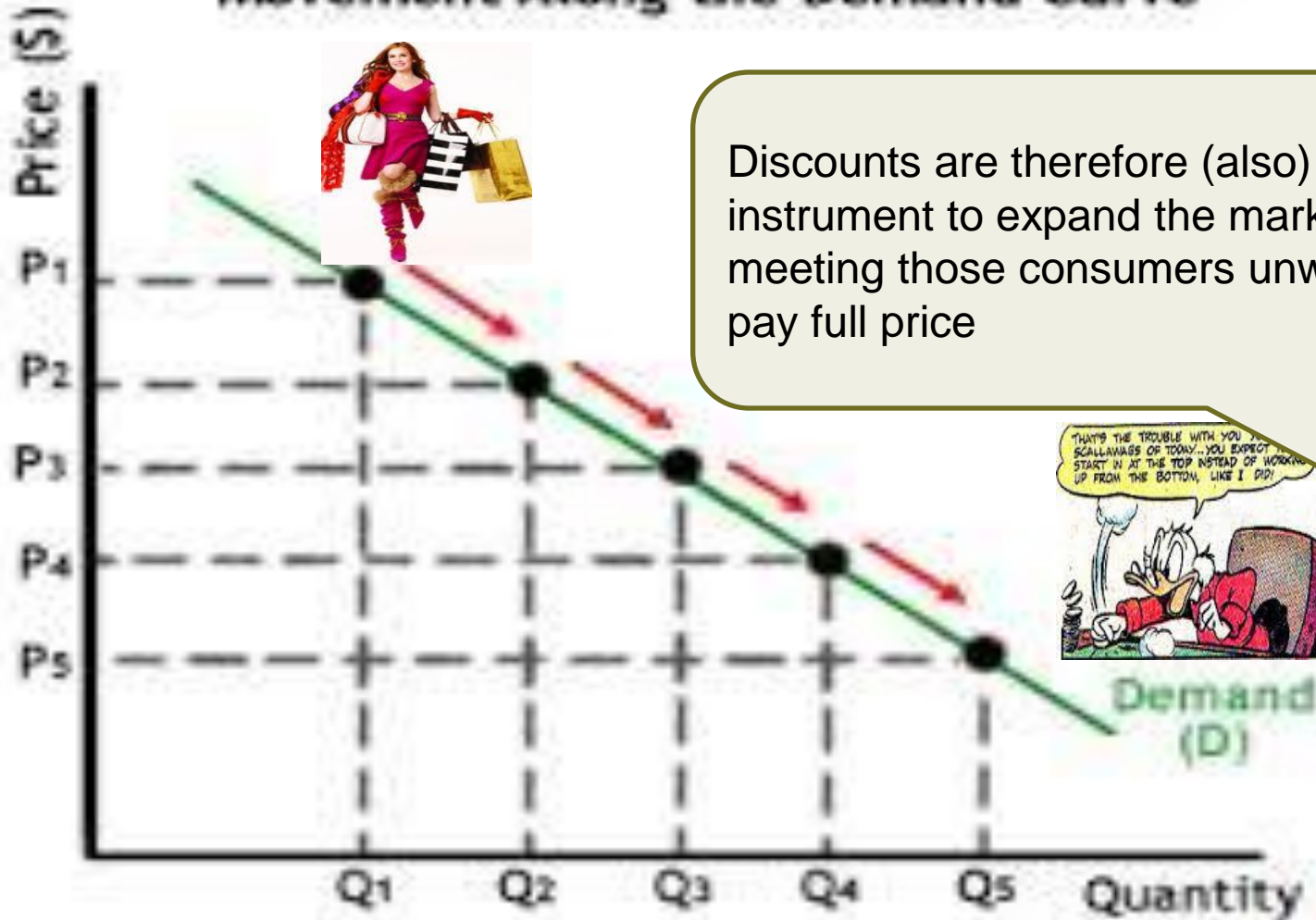


Få et Coop-kort - og få mere med hjem!



The alternative explanation

Movement Along the Demand Curve



Discounts are therefore (also) an instrument to expand the market by meeting those consumers unwilling to pay full price

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The alternative explanation

- The alternative explanation merits some policy implications



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A prudent approach is required

1. It's too simplistic to consider discounts as anti-competitive *per se* because other explanation are available



Foreclosure must be plausible

2. Condemnation should be reserved to discounts (truly) able to create a foreclosure *effect* or (at a minimum) a *risk*, and it should fall upon the Commission to establish this



Loyalty is perhaps mislabeling

3. Under the anti-competitive story. Who gets the discount?
 1. The super-loyal customers with no intention of switching
 2. The less loyal customers predominantly with the dominant undertaking
 3. The disloyal customer predominantly with the competitor



Effect, not form, should matter

4. Reserving condemnation to **anti-competitive discounts** requires a wider approach to the latter, as discounts could:
- a) be **loyalty-inducing**, replacing a formal exclusive agreement leading to a customer foreclose
 - b) loss-making and selective within the concept of **predatory pricing**
 - c) **bundle products or services** combining an exploitation of consumer and foreclosure of competitor
 - d) have **discriminatory effect** distorting competition downstream



Turning to reality and the appraisal of discounts



Hoffmann La Roche & Michelin I establish the foundation

In *Hoffmann La Roche* (recital 90), it was found abusive:

“ ...if the [dominant] undertaking, **without.....a formal obligation**, applies, either under the terms of agreements concluded with these purchaser or unilaterally, a system of **fidelity rebates..**”



Hoffmann La Roche & Michelin I establish the basis

Michelin I (recital 73) establish that a discount should be assessed against:

*“..all the circumstances, particularly the criteria and rules for the grant of the discounts, and to investigate whether, in providing an **advantage not based in any economic service** justifying it, the discounts tends to **remove or restrict the buyers’s freedom** to choose his source of supply, to **bar competitors from access** to the market...”*



Hoffmann La Roche & Michelin I establish the basis

1. Effect instead of form matters, and a discount replacing a formal exclusive agreement is assessed by the same principles:
 - a) In *Hoffmann La Roche & Michelin I*, the discounts were offered as **individualized target discounts** estimated against the previous years acquisitions
 - b) In *Hoffmann La Roche*, the discount was calculated across different products, and therefore had a **bundling element**. This was taken further by *Napir Brown* where delivery was included and hence involved a bundle (product + delivery)
 - c) In *Soda – Solvay & Irish Sugar* the discounts were offered on **extra acquisitions** (top slides discounts) but in contrast to *Michelin I* only calculated on the top slides



Hoffmann La Roche & Michelin I establish the basis

1. Effect instead form matters, and a discount replacing a formal exclusive agreement is assessed by the same principles:
 - d) In *Van den Bergh Foods*, the discounts came in the form of **free freezers** reserved for the supplier's products. Arguing that space in a kiosk is limited, **de facto exclusivity** was identified by the Commission
 - e) In *Intel*, **cash payment** was sided with a discount (referred to as naked restraints) and a **perception** with the buyer sufficient to identify exclusivity



Effect rather than form - exceptions

1. Effect instead of form matters, and a discount replacing a formal exclusive agreement is assessed by the same principles:
 - a) *an advantage ... based [on] economic service justifying it c.f. Michelin I. Hence, cost reductions can be passed on*
 - b) *The Coca Cola settlement (1990) indicates that individualized target discounts might be allowed if the reference period is (very) short, in effect limiting the sucking.*
 - c) *The Enforcement Paper (2009) outlines more detailed principles*



Effect rather than form - *Enforcement Paper*

- The *Enforcement Paper* (2009) outlines more detailed principles
 - a) **Top slides discounts** (*Soda – Solvay & Irish Sugar*) should be appraised as predatory pricing limiting abuse to when marginal price (price per extra units) failing to cover the dominant undertakings AAC/AVC thereby potentially excluding an equally efficient competitor
 - b) The same applies for volume discounts and selective price cuts awarded **unconditional**
- An approach largely adopted in *Post Danmark I*, where the Court of Justice excluded that (unconditional) price cut covering AIC could be considered abusive



Effect rather than form - *Enforcement Paper*

- The *Enforcement Paper* (2009) outlines more detailed principles
 - c) Combo discounts, e.g., “buy two get an extra free” (**mixed bundling**), are appraised against an *effect test* and *an equally efficient competitors (AEC)* ability to meet the offer
 - d) The same applies for discounts offered subject to **conditions**, e.g., 10 % increase over last year and with a **retro element** (calculated on the basis of earlier acquisitions)



Effect rather than form - *Enforcement Paper*

- The *Enforcement Paper* (2009) outlines more detailed principles



Popcorn	= EUR 3
Soda	= EUR 3
Combo	= EUR 5
(Discount	= EUR 1)
(effective price for soda/popcorn	= EUR 2)

If an AEC stand-alone supplier can meet the EUR 2 effective price, there is no foreclosure and thus no abuse

Effect not form should matter

4. Reserving condemnation to **anti-competitive discounts** requires a wider approach to the latter, as discounts could:

- a) be **loyalty-inducing**, replacing a formal exclusive agreement leading to a customer foreclose
- b) Loss-making and selective within the concept of **predatory pricing**
- c) **bundle products or services** combining an exploitation of consumer and foreclosure of competitor
- d) have **discriminatory effect** distorting competition downstream



Effect not form should matter

4. Reserving condemnation to **anti-competitive discounts** requires a wider approach to the latter because discounts could:

a) loyalty inducing and bundle discounts are appraised under the AEC test, reserving condemnation to situations when a foreclosure are plausible

➤ The AEC test was used in *Tomra* (2006) & *Intel* (EC Commission 2009) essentially to check the conclusions. However, in the latter the Commission maintained that it was not under any such obligation

d) have **discriminatory effect** distorting competition downstream



Hoffmann La Roche & Michelin I establish the basis

Hoffmann La Roche and *Michelin I* establish the basis for assessing discrimination. In the latter (recital 73), the discounts were also held to be abusive for offering:

“dissimilar conditions to equivalent transaction with other trading parties....”

Giving ground to the misperception that dominant undertakings are obligated to offer all customers similar (good or bad) conditions and adjust any discount program accordantly



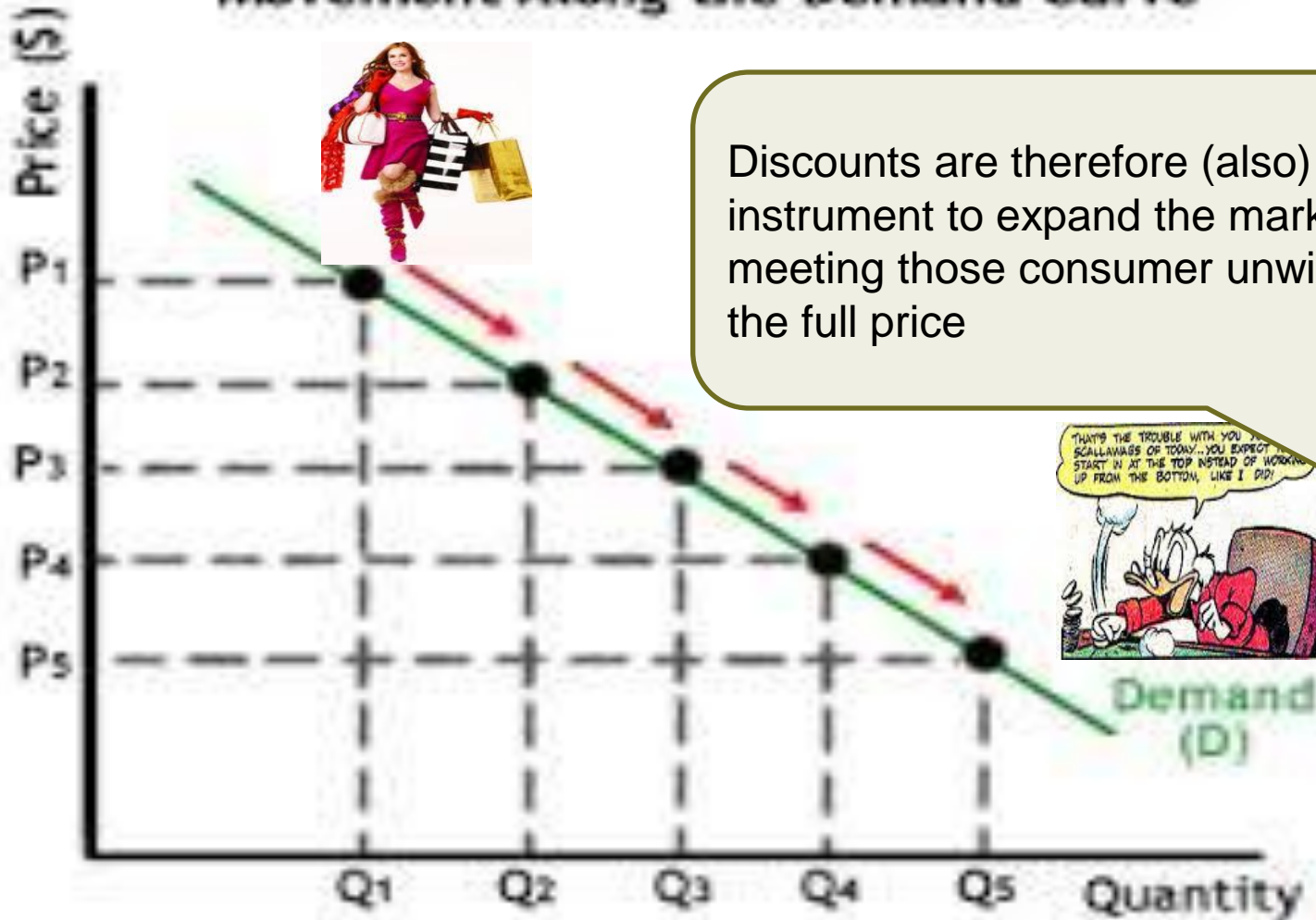
Discriminatory discounts

- That was corrected by, e.g., *BdKEP/Deutsche Post* (2004) where in recital 93 the Commission held that:
 - *"The wording [of Article 102] covers three types of discrimination, **the first two of them exclusionary** and the last **one exploitative**: (i) the customer of the dominant firm is placed at a competitive disadvantage vis-à-vis the dominant firm itself; (ii) in relation to other customers of the dominant firm; or (iii) **the customer suffers commercially** in such a way that its ability to compete in whatever market is impaired"*
- Thus, **discrimination & discriminatory discounts** are only condemned if **exclusionary** under the AEC test or **abusive by other standards**



The alternative explanation

Movement Along the Demand Curve



Discounts are therefore (also) an instrument to expand the market by meeting those consumer unwilling to pay the full price

Exploitative discounts

Targeting the individual willingness to pay could *potentially* be held as abusive as held by the Commission in the *Discussion Paper* (2005) predating *Enforcement Paper*. In recital 141 it was noted:

“The direct exploitation takes place by discriminating between customers and making customers with a higher willingness to pay and less switching possibilities pay a higher price than others”

However, the consideration was not cited in the *Enforcement Paper* nor supported by case law. *Deutsche Bahn* (recital 91), *UBS* (recital 228) & *Port of Helsingborg* (241) don't condemn (*per se*) behavior capitalizing on (some) customers' higher willingness to pay, thereby potentially opening a (small) window



A happy ending?

- Would have been wonderful if I could stop the story here and conclude that a coherent frame for assessing discounts now had been established. In short, a happy ending



Regrettably things are less clear

- First, the *Discussion Paper* from 2005 reserves the right to condemn discounts capitalizing on (some) customers willingness to pay a premium ignoring older case law as *Deutsche Bahn* (1997), *UBS* (1978) & *Port of Helsingborg* (2004). The idea was dropped in the latter *Enforcement Paper*, but perhaps not forgotten
- Second, it's still unclear how to approach national discrimination, e.g., discounts reserved for either certain citizens or more likely customers within the proximity of a border and consequently more prone to switch. *Whish* isolates the “problem” in a separate chapter on “*Pricing Practice that are Harmful to the Single Market*” pp. 764-766 and *Faull & Nikpay* pp. 404-407 (2007 version) largely do the same - thereby ignoring the problem



Regrettably things are less clear

- Third, and more problematic, *BdKEP/Deutsche Post* identified three forms of discrimination of which we only have addressed two:
 - *"The wording [of Article 102] covers three types of discrimination, **the first two of them exclusionary** and the last **one exploitative**: (i) the customer of the dominant firm is placed at a competitive disadvantage vis-à-vis the dominant firm itself; (ii) in relation to other customers of the dominant firm; or (iii) **the customer suffers commercially** in such a way that its ability to compete in whatever market is impaired."*
- Discounts reserved to groups of customers, and not others, could be considered **abusive if distortive**. However, how much distortion is required?



Regrettably things are less clear

- Fourth, and (even more troublesome), the General Court used *Intel* (2014) to state that:
 - a) the *Enforcement Paper* (recital 155-156) doesn't govern cases predating its adoption
 - b) there are no requirement (recital 80) to conduct an effect analysis for exclusivity rebate thereby killing the *Enforcement Paper* and its approach



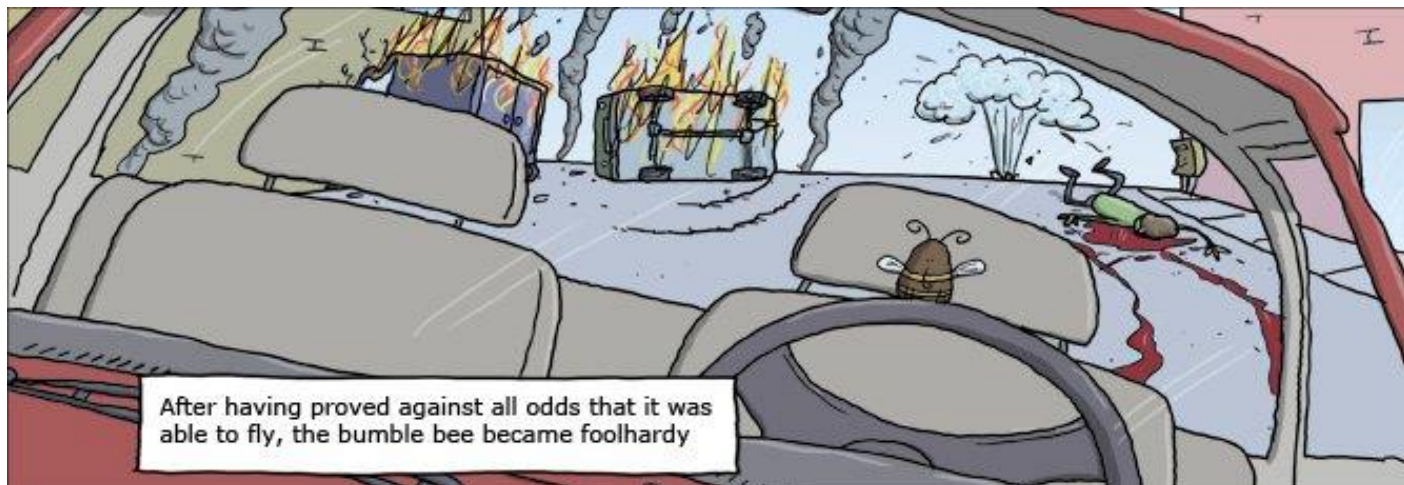
Intel?

- Much can be (and has been) said on *Intel*. Currently, it is on appeal to the Court of Justice and the mandatory use of the *Enforcement Paper* has been tabled in a separate case (*Post Danmark II*) before the same, thus giving a double chance to set the record straight. Hence, we will be much wiser on the issue in a couple of years



Intel?

- Until then, a cautious approach is advised outside the window established by early practice
 - a) cost reductions c.f. *Michelin I*
 - b) Short reference periods c.f. *the Coca Cola settlement*



Cases cited

- Case C-85/76 - *Hoffmann La Roche*
- Case C-27/76 - *UBS*
- Case C-322/81 - *Michelin I*
- IP/90/7 - *coca cola*
- Case T-229/94 - *Deutsche Bahn*
- COMP/A.36.568/D3 - *Scanlines Sverige AB vs. Port of Helsingborg*
- Case C-549/10P - *Tomra*
- COMP/C3/37-37.990 - *Intel* & case T-286/09 - *Intel*
- Case C-209/10 - *Post Danmark I*
- Case C-23/14 - *Post Danmark II*



Questions



Or contact me on cbe@jur.ku.dk